

Renewable Energies and Rural Development

Business Finance and the Role of Trust

Business Finance and Rural Development

While politics have identified renewable energies as the engine for rural development, not much attention has yet been paid to the financing of small and medium-sized enterprises (SME) in the renewable energies sector. The international financial markets have been in a process of re-structuring since the 1990s which has resulted in both, an institutional concentration and a geographical consolidation of the German banking sector. Especially in rural areas many bank branches have been closed. Moreover, strong international competition and political regulation have forced banks to standardize their processes and give up the traditional system of relationship banking. However, the communication process between the bank's customer adviser and the SME management is still crucial for the banks in order to collect soft information (figure 1). But in rural regions the distance between those two parties tends to be longer compared to other regions, hence face-to-face contacts are more expensive. Does that mean that renewable energies-focused SME in rural regions are disadvantaged concerning their finance?

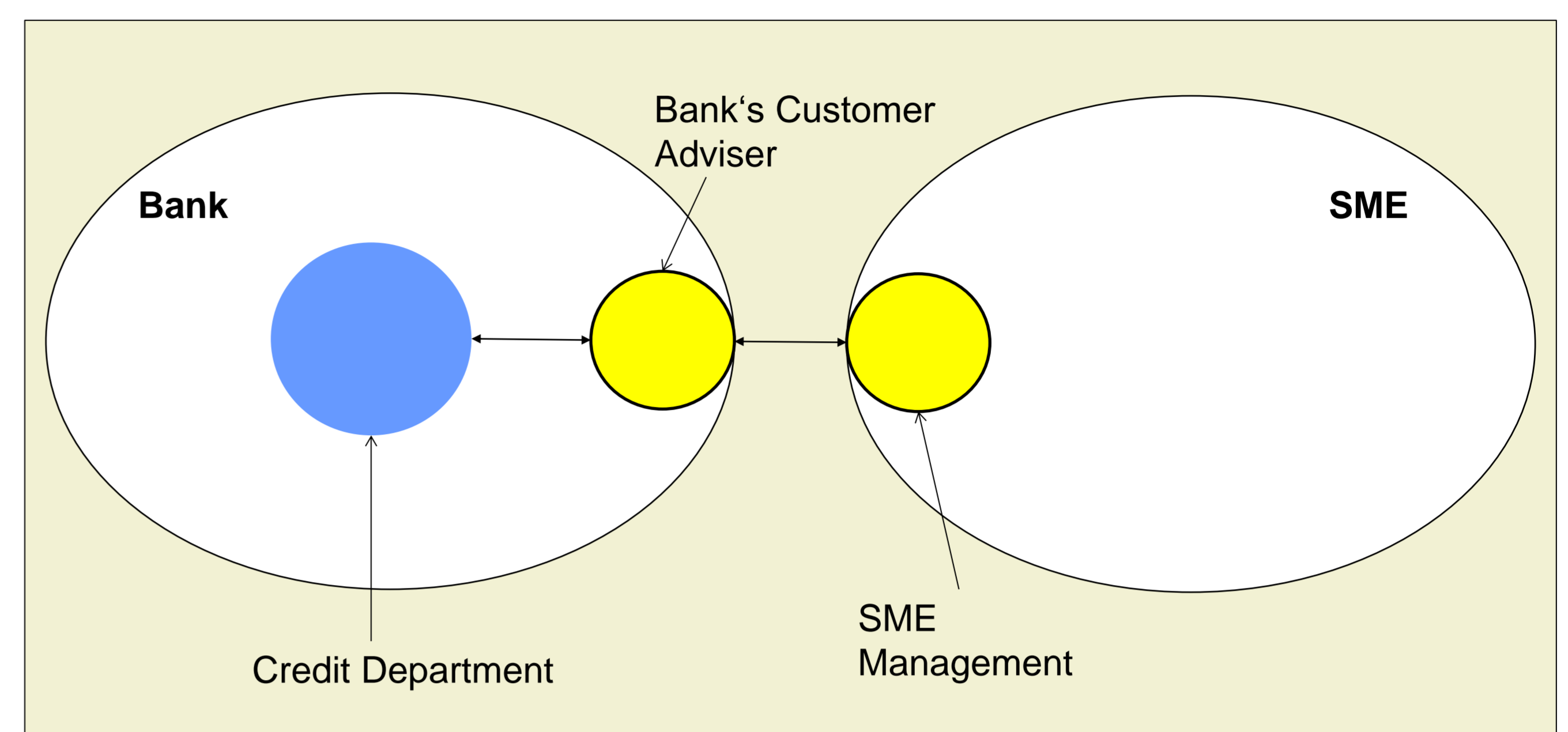


Figure 1: Communication during the process of credit approval.

Relationships between Banks and Renewable Energies-Focused SME

With the help of an analyzing framework in which standardization and individualization are seen as two extremes in a continuum of modes of interaction, the relationships between banks and renewable energies-focused SME in Germany were analyzed (figure 2). Standardization as an anonymous mode of interaction allows a high number of transactions to low costs due to economies of scale. However, loyalty of clients is relatively low. Individualization on the other hand is characterized by custom-made elements of interaction. Correspondingly, costs are higher. However, individualized bank-business-relationships allow a very good access to information for the bank. The intenseness of interaction is reflected in the degree of standardization respectively individualization and can be low, medium or high.

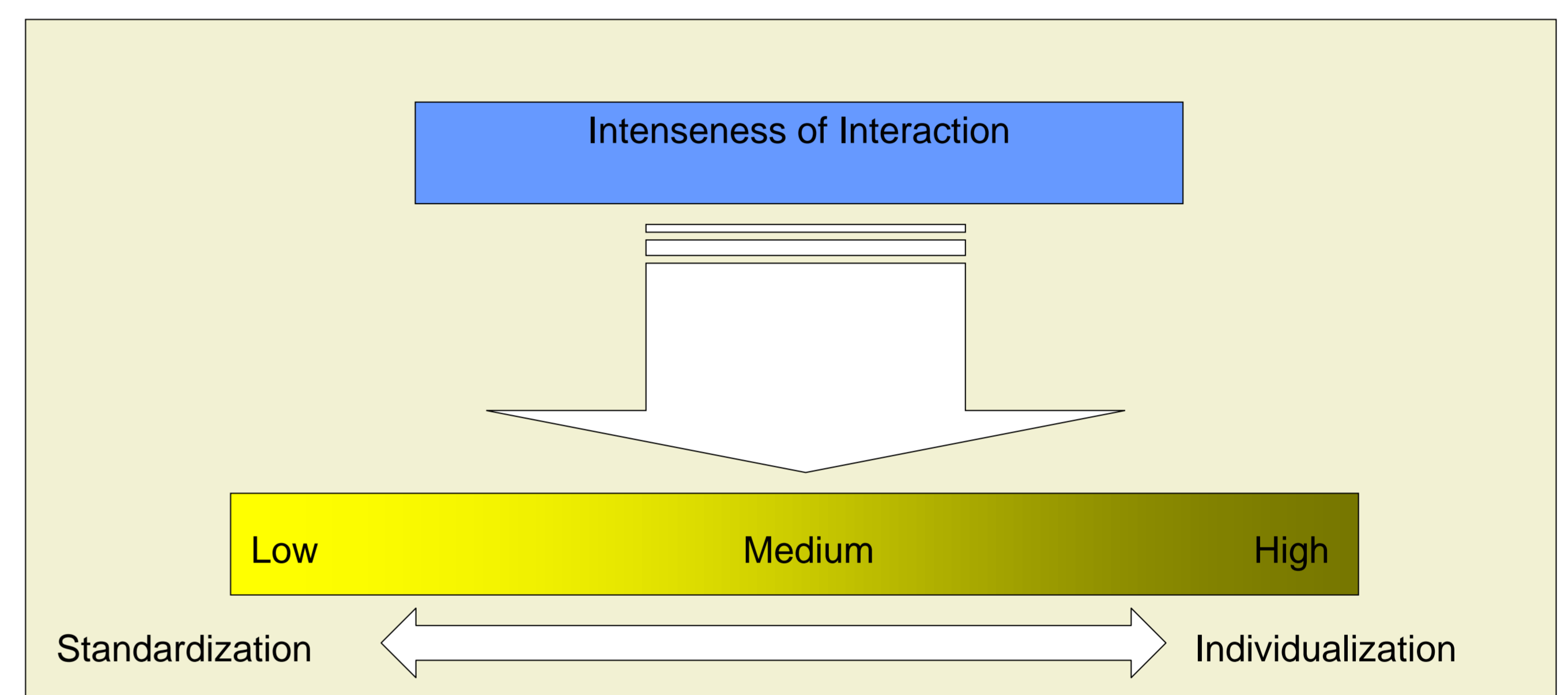


Figure 2: Framework for analysing the intenseness of interaction in bank-business-relationships.

Additionally, a situational model of trust including five forms of personal trust was developed (figure 3). The five forms of trust are: faith-based trust (initial trust - A), dependence-based trust (calculative, rational trust - B), competence trust (trust in the partner's expertise and qualifications - C), good-will trust (trust that the partner abstains from opportunistic behaviour - D), and confidence-based trust (clear identification with the partner, long history of interaction as a requirement - E). Trust is recognized as reciprocal.

On the basis of these two frameworks a sample of 20 relationships between banks and renewable energies-focused SME in Germany and their development over the years were analyzed. For this purpose, interviews with SME managements as well as with their banks' customer advisers were conducted and the effects of different modes of interaction in the relationships between the banks and the SME were analyzed. Thereby, aspects of personal trust and its genesis in the context of geographical distance were the focal point of the study. The analyzed SME were spread all over Germany and worked in different sectors of the renewable energies industry such as photovoltaic, solar heat, wind energy, hydraulic power, and biogas. The geographical distance between the SME and their banks varied between 0.5 km and 190 km.

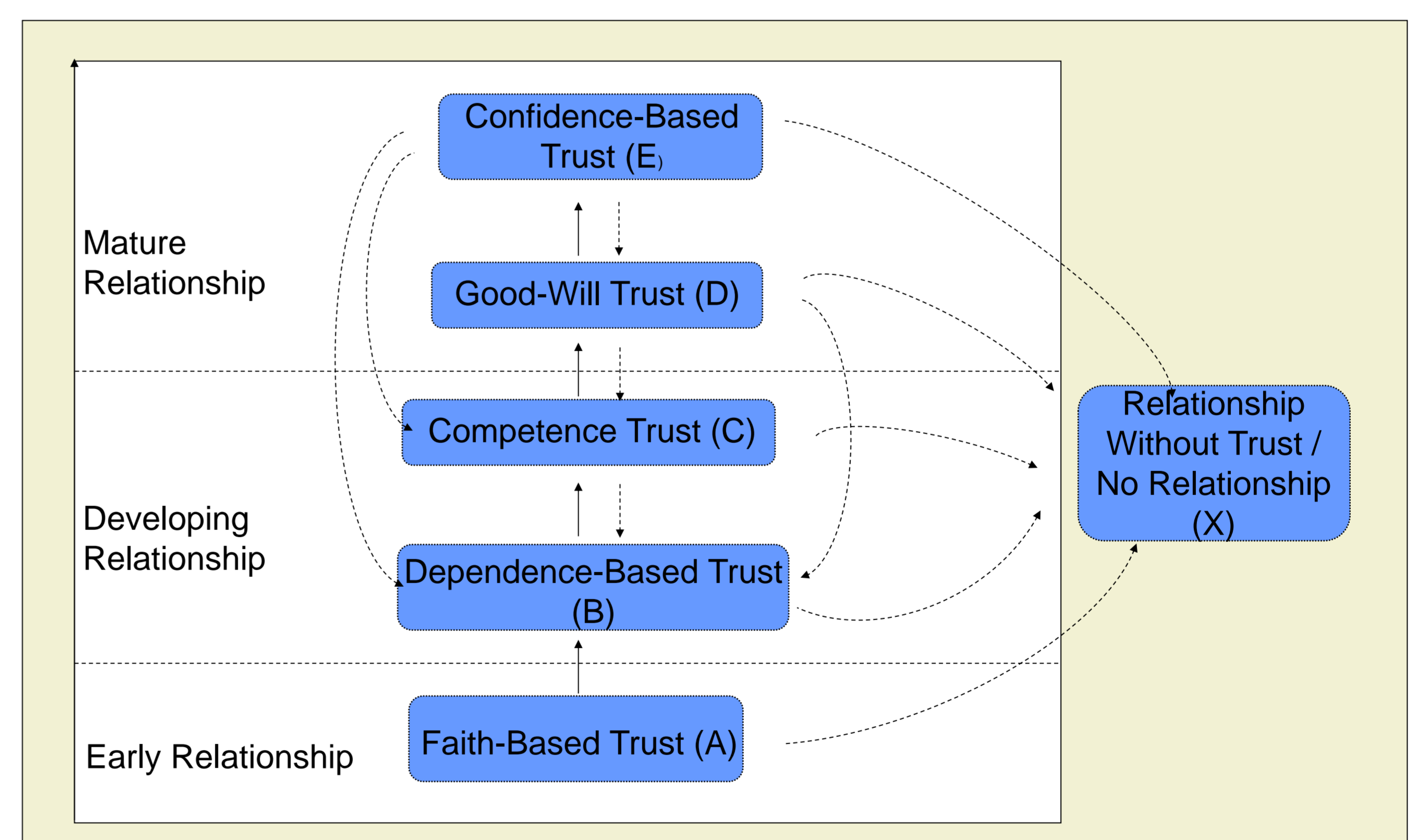


Figure 3: Model of situational trust (Source: based on Dibben (2000) and Glückler (2004)).

Results

The analysis of the intenseness of interaction showed that there is a tendency towards a high individualization in the bank-business-relationships of the sample. However, there is no coherence between the intenseness of interaction and the geographical distance between the actors. As shown in figure 4, more intense relationships do not necessarily lead to a higher quality of trust, but rather to a higher intenseness of interaction. Therefore, the optimal mode of interaction is based on a medium intenseness of interaction accompanied by higher qualities of trust, e.g. competence trust and in particular good-will-trust. These forms of trust have the potential to reduce transaction costs for credit institutions.

The analysis showed that personal trust is built, but can also be lost in phases of a high trust dynamic. These phases mostly occur when there is a high need of interaction which is generally met by face-to-face-contacts. This occurs for example during credit approval processes. On the other hand, in phases of a low trust dynamic there is nearly no interaction at a stable level of trust. Such phases of a low trust dynamic hold possible savings of transaction costs – provided that trust had been created before. The continuing regeneration and maintenance of trusting relationships in those phases is not necessary, which means that face-to-face-contacts can be reduced. This also reduces the intenseness of interaction significantly.

While trust between the SME management and its bank's customer adviser does not guarantee access to finance, it still plays a vital role in order to have one's foot in the door and to be considered for financing. So SME in rural areas that work in the renewable energies sector are not necessarily disadvantaged concerning their finance, as there is no need for a permanent geographical proximity between the actors. This means that the renewable energies sector indeed has a high potential to be the engine for rural development.

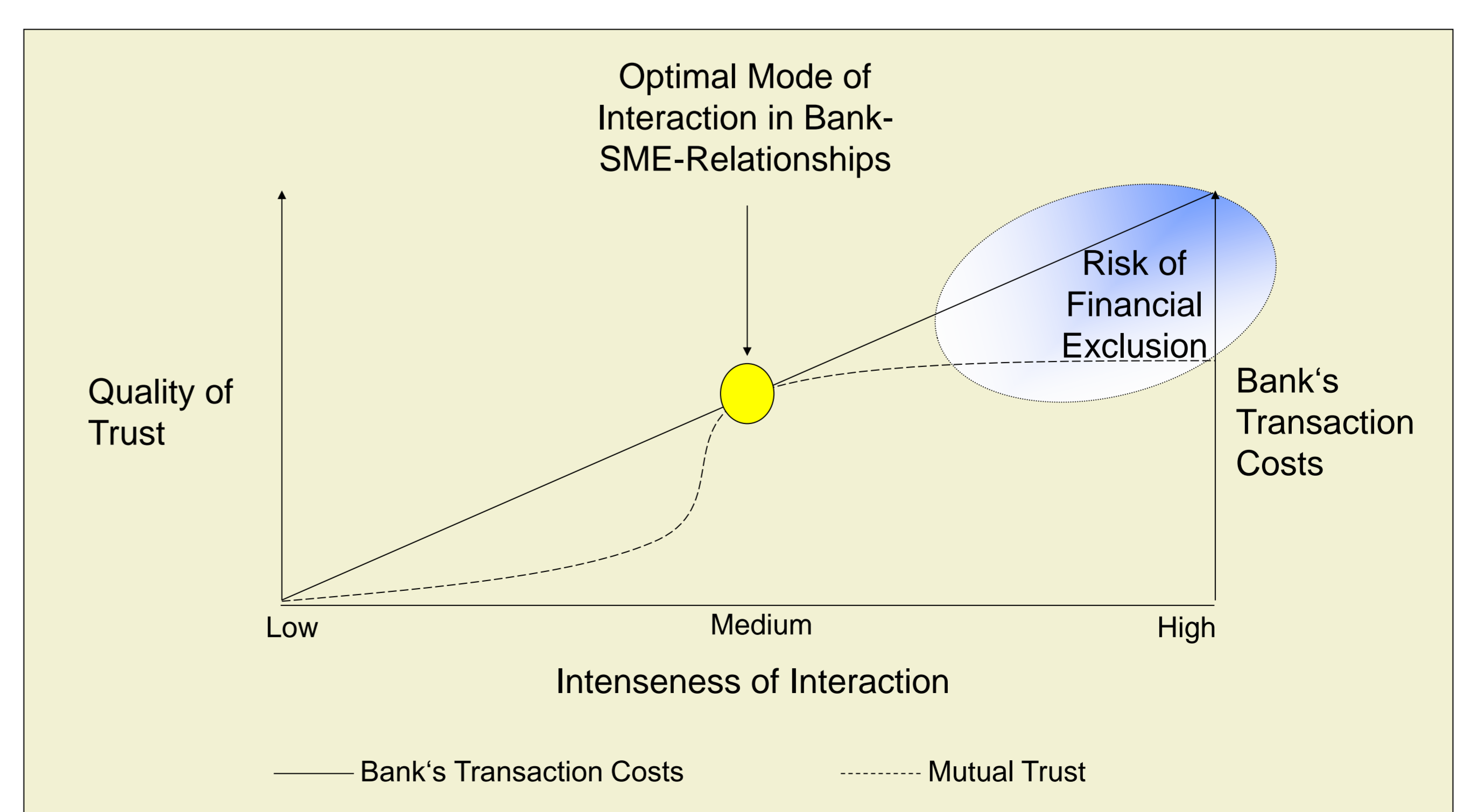


Figure 4: Interdependencies between intenseness of interaction, bank's transaction costs and personal trust between SME-management and bank's customer adviser.